

***United States Court of Appeals
for the Second Circuit***



**PETITIONER'S
BRIEF**

77-4078

To be argued by
WILLIAM E. WILLIS

United States Court of Appeals
For The Second Circuit

Docket No. 77-4078

SCM CORPORATION,
—against—
FEDERAL TRADE COMMISSION,
Petitioner,
Respondent.

ON PETITION FOR REVIEW OF A
FINAL ORDER OF THE FEDERAL TRADE COMMISSION

BRIEF FOR PETITIONER

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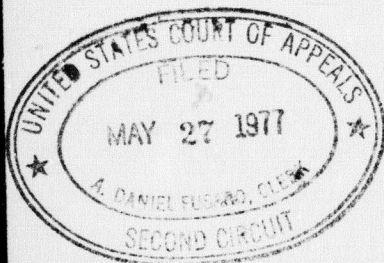


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—against—

FEDERAL TRADE COMMISSION,

Respondent.

BRIEF FOR PETITIONER

Preliminary Statement

SCM Corporation ("SCM") seeks review of the final order of the Federal Trade Commission ("FTC" or "Commission") entered January 11, 1977. That order and accompanying opinion present basic issues relating to the enforcement of Section 8 of the Clayton Act, 15 U.S.C. § 19, regulating interlocking directorates.¹

This proceeding does not involve the propriety of the director interlock. Richard C. Bond ("Bond"), the involved director, voluntarily resigned from the board of SCM immediately after the FTC issued its complaint. The question here is whether the FTC's issuance of a broad prospective cease and desist order against SCM is justified on the facts and the law.

1. This is the first litigated FTC proceeding under Section 8 and the first to reach a Court of Appeals. This case, therefore, presents the first opportunity for a Court of Appeals to review the FTC's admitted practice of "routinely" issuing cease and desist orders in Section 8 cases solely on the basis of past violations and without any evidence of a need for prospective injunctive relief.

Specifically, SCM questions the Commission's power to enter a cease and desist order extensively regulating petitioner's future conduct when there is no evidence to support the determination, held by the Supreme Court in *United States v. W. T. Grant Co.*, 345 U.S. 629, 633 (1953) to be a precondition to granting prospective injunctive relief in Section 8 cases, that there exists "some cognizable danger of recurrent violation, something more than the mere possibility which serves to keep the case alive." In addition, this appeal squarely presents the question, previously reserved by the Supreme Court, of whether a corporation, as distinguished from an individual director, can violate Section 8 of the Clayton Act. Also at issue is the power of the Commission to invoke Section 5 of the Federal Trade Commission Act ("FTC Act"), 15 U.S.C. § 45, as a catch-all provision conferring virtually unlimited authority on the FTC to regulate interlocking directorates deliberately left unregulated by Congress in Section 8 of the Clayton Act. Finally, SCM challenges the Commission's decision to punish SCM for exercising its constitutional right to litigate the FTC's legal claim to prospective injunctive relief against a corporation by imposing on it a cease and desist order that is substantially more severe than the consent order imposed upon Bond and Krafteo Corporation ("Krafteo") for the same alleged violation.

The Issues Presented For Review

1. Did the Commission err in entering a broad cease and desist order regulating SCM's future conduct without any showing that there exists some cognizable danger of a recurrent violation of Section 8 of the Clayton Act?
2. Does Section 8 of the Clayton Act impose substantive liability on a corporation, as distinguished from an individual director?

3. Is the Commission empowered under Section 5 of the Federal Trade Commission Act to regulate interlocking directorates covered by Section 8 of the Clayton Act but deliberately left unregulated by Congress?

4. Did the Commission unlawfully violate SCM's constitutional rights: (a) by changing its rules of practice in the middle of its investigation of SCM and then issuing a complaint without any advance notice that SCM was under investigation for a possible violation of Section 8; or, (b) by imposing on SCM, for the same alleged violation, a cease and desist order substantially more severe than the consent orders imposed upon Bond and Kraftco when the only articulated reason for the harsher treatment of SCM was its decision to exercise its constitutional rights?

So that the issues on this appeal will be clear, it should be noted that SCM does not appeal from the Administrative Law Judge's determination on stipulated facts that:

"(1) Bond served simultaneously on the Board of Directors of both SCM and Kraftco; (2) both corporations are engaged in 'commerce' and have capital, surplus, and undivided profits aggregating more than \$1,000,000; and (3) the two corporations compete." (footnotes omitted) (A123-124).

Nor does SCM assert a *de minimis* defense as such.² SCM does urge, however, that in judging SCM's past conduct as it may relate to the appropriateness of injunctive relief, consideration should be given to the amount of competition involved, less than 7% of SCM's total sales (less than

2. We point out however that the existence of such a defense has been recognized. *Paramount Pictures Corp. v. Baldwin-Montrose Chemical Co., Inc.*, [1966] Trade Cases (CCH) ¶ 71, 678 (S.D.N.Y.); *United States v. Sears, Roebuck Co.*, 111 F. Supp. 614, 621 (S.D.N.Y. 1953). Indeed, the Kraftco order (A139-143) gives implicit recognition to *de minimis* considerations in Section II where directors' certification is not required with respect to competition in products which account for less than 5% of Kraftco's annual gross revenues.

6% of Kraftco's total sales). Finally, while SCM does not argue on this appeal that the complaint should be dismissed as moot because of Bond's resignation, SCM strongly urges that his prompt resignation is directly relevant to consideration of the appropriateness of a cease and desist order or any other form of prospective injunctive relief.

Statement of the Case

A. Procedural History

The FTC complaint (A12-17),³ served on Bond, Kraftco and SCM on July 22, 1975, alleged that the simultaneous service of Bond on the boards of directors of Kraftco and SCM violated Section 8 of the Clayton Act and Section 5(a)(1) of the FTC Act because the corporate respondents each had capital, surplus, and undivided profits in excess of \$1 million and were competitors in the manufacture and sale of margarine, edible oils and barbecue sauce.

The FTC's complaint asserted no improper or unlawful conduct by any of the respondents, other than the alleged interlock. There were no allegations of any unfair trade practice or other anticompetitive conduct and, most significantly, there was no allegation of a "cognizable danger of recurrent violation."

Bond voluntarily resigned from the board of directors of SCM on August 1, 1975, ten days after the FTC complaint was served. SCM filed its answer (A24-28) to the complaint on November 17, 1975. While admitting that Bond had been a member of SCM's board of directors prior to August 1, 1975, SCM denied that Bond was a director after that date. Bond and Kraftco also filed answers; but, there-

3. References to ("A _____") in this brief refer to pages in the Joint Appendix.

after, both entered into consent orders which were accepted by the Commission (A59-61 and A139-143).

At the same time that it filed its answer, SCM moved for summary decision on the grounds that Bond's voluntary resignation from the board of SCM rendered the proceeding moot and that no prospective injunctive relief against SCM was required to protect the public interest. SCM also argued that Section 8 does not apply to corporations and that the Commission's discriminatory enforcement of Section 8 precluded the imposition of sanctions against SCM.

The Staff cross-moved for summary decision on the ground that a violation of Section 8 by SCM was conclusively proved by an affidavit (A29-33), submitted by SCM in support of its motion for summary decision, admitting Bond's simultaneous service on both boards and the existence of some competition between the two companies.

The case was submitted to the Administrative Law Judge ("ALJ") on a stipulated record (A62-116). On June 17, 1976, the ALJ filed an initial decision (A118-137) finding a violation of Section 8.

SCM appealed to the Commission (A138) and, on January 11, 1977, the Commission affirmed the decision of the ALJ and directed the entry of a broad cease and desist order against SCM (A144-164).

SCM timely filed its petition for review (A165-166) pursuant to 15 U.S.C. §§ 21 & 45 on March 24, 1977.

B. The Facts

SCM is a New York corporation with its principal offices in New York. SCM is an industrial corporation which manufactures and sells various products including typewriters, business equipment, home appliances, paint, resins, food, chemicals and paper. Total SCM sales in the fiscal

year ended June 30, 1975, were \$1,287,000,000. In fiscal 1975, SCM had aggregate sales of margarine, edible oils and barbecue sauce in competition with Krafteo of approximately \$83 million. (Stipulated Record, para. 1, A62-63.)

Krafteo is a leading processor and distributor of cheese and dairy products. Total Krafteo sales in the year ended December 31, 1974, were \$4,500,000,000. Among other food products, Krafteo sells margarine and barbecue sauce to the retail trade. Krafteo also refines edible oils both for its own use and for sale to industrial and food service customers. In fiscal 1975, Krafteo's total sales of margarine, edible oils and barbecue sauce, sold in competition with SCM, were approximately \$258 million. (Stipulated Record, para. 1, A62-63.)

Bond has been a member of the board of directors of Krafteo since 1957. He was elected to the board of SCM in 1967 and voluntarily resigned as a director of SCM on August 1, 1975—within ten days after SCM was served with a copy of the FTC complaint. His resignation was submitted prior to the first SCM board of directors' meeting after service of the complaint. (Aff. of Richard Sexton, paras. 6 & 7, A31.)

It is not disputed that SCM was never advised in advance as to the FTC's claim of a violation of Section 8. The only evidence with respect to advance notice was submitted by SCM, whose officer swore that prior to the complaint "no claim had been made by the FTC to SCM with respect to the alleged interlock with Krafteo; and there had, therefore, been no request, oral or written, by the FTC to SCM to correct the alleged violation". (Sexton Aff., paras. 7 & 8, A31-32.)

On November 16, 1975, in the very initial stages of the proceeding and seven months before the ALJ's initial decision, SCM assured the Commission that Bond would not be re-elected to the board of directors of SCM so long

as he was a director of "Krafteo or any corporation which competes or might compete in any line of commerce with SCM." (Sexton Aff., para. 10, A32-33.)⁴

The Commission rejected SCM's voluntary assurance and instead entered a broad cease and desist order wholly unwarranted by the facts of this case.⁵

Jurisdiction and Standards of Review

This Court has jurisdiction over SCM's petition for review under 15 U.S.C. §§ 21 & 45.

Review of the FTC's final order is governed by a three-fold standard of review: error as a matter of law—as to the standard of law applied by the Commission in entering a cease and desist order and as to its conclusions of law, *SEC v. Chenery Corp.*, 318 U.S. 80, 94 (1943); substantial evidence—as to the ALJ's and Commission's fact findings, *Rayex Corp. v. FTC*, 317 F.2d 290, 292 (2d Cir. 1963); and,

4. Such a voluntary assurance of future compliance is specifically contemplated by the Commission's voluntary compliance procedures. Indeed, every consideration specified in the FTC Rules as justifying the use of informal procedures is present here. Section 2.21 of the Commission's Rules of Practice provides:

"Subpart B—Informal Enforcement Procedure.

§ 2.21 Voluntary compliance.—(a) The Commission, when it has information indicating that a person or persons may be engaging in a practice which may involve violation of a law administered by it, and if it deems the public interest will be fully safeguarded thereby, may afford such person or persons the opportunity to have a matter disposed of on an informal nonadjudicatory basis.

(b) In determining whether the public interest will be fully safeguarded through such informal administrative action, the Commission will consider: (1) the nature and gravity of the alleged violation; (2) the prior record and good faith of the parties involved; and (3) other factors, including, where appropriate, adequate assurance of voluntary compliance."

5. The FTC Staff in its later arguments before the Commission contended that SCM's voluntary assurances were insufficient in that they did not go far enough. At no point did the Staff ever indicate to SCM what additional voluntary assurances they would require; but persisted in demanding entry of a broad cease and desist order.

abuse of discretion—as to the form and scope of the Commission's cease and desist order, *Federated Nationwide Wholesalers Service v. FTC*, 398 F.2d 253, 260 (2d Cir. 1968).

Statutes Involved

Three statutes, Sections 8 and 11 of the Clayton Act, 15 U.S.C. §§ 19 and 21, and Section 5 of the Federal Trade Commission Act, 15 U.S.C. § 45, are involved in this petition for review. Each of these statutes is set forth, in relevant part, in a statutory appendix to this brief.

ARGUMENT

While each of the specific issues presented on this appeal will be analyzed separately *infra*, some mention must initially be made of the Commission's overall conduct in initiating and prosecuting this proceeding against SCM. Contrary to its longstanding practice of instituting only informal proceedings and of giving advance notice of an investigation into a possibly illegal interlock, thereby affording a corporation an opportunity to conduct its own investigation to determine if any of its directors or officers may be in violation of Section 8 and to eliminate voluntarily any violation, the Commission in this case deliberately chose not to inform SCM that *it* was being investigated.⁶ After the complaint issued, the Commission refused to consider any settlement that did not include a broad cease and desist order against SCM, even though Bond had immediately resigned.

In granting the Staff's demand for injunctive relief, first the ALJ and then the Commission held that the burden

6. As discussed in the Statement of Facts *supra*, two Commission employees spoke to Mr. Sexton of SCM before issuance of the complaint but never told him that SCM was the target of a Section 8 investigation.

was on SCM to prove that a broad cease and desist order should not issue—thus standing the usual standards for injunctive relief on their head. When SCM protested that the Commission entered into consent orders with Kraftco and Bond that were substantially less severe than the cease and desist order imposed on SCM, for precisely the same conduct, the Commission had the temerity to hold that a proper factor to consider in assessing the public interest was whether the respondent chose to exercise its constitutional rights to defend against the Commission's charges. Since litigation against the FTC costs the public money, it was entirely proper, according to the Commission, to treat the unsuccessful litigant more severely than the respondent who waived its due process rights and entered into a consent decree, thereby saving the Commission the time and expense of proving its case. It is difficult to imagine a more pervasive chill on the exercise of constitutional rights.

In short, this case presents a clear example of the abuse of administrative power and the perversion of the administrative process. SCM urges this Court to grant its petition for review and to vacate the Commission's cease and desist order. On its part, SCM reiterates in this Court the same voluntary assurances that it gave to the Commission in 1975.

I.

The Staff Has Failed To Meet Its Burden of Proof To Support an Award of Injunctive Relief.

There is no evidence, indeed no allegation in the complaint, of any danger of recurrent violation by SCM of Section 8 of the Clayton Act. Bond resigned as a director of SCM almost two years ago and since that time the Commission has raised no objection to the composition of

SCM's board. In short, the FTC accomplished by prompt voluntary action full compliance with Section 8 and has not shown any need for prospective injunctive relief.

In *United States v. W. T. Grant Co.*, 345 U.S. at 633, the Supreme Court established the standard for injunctive relief in Section 8 cases. That the Commission applied an erroneous test to determine whether an injunction should issue in this case, is obvious from a comparison between the language in the Commission's decision and the Supreme Court's holding in *Grant*.

The Grant Case

"The purpose of an injunction is to prevent future violations, [citation omitted] and, of course, it can be utilized even without a showing of past wrongs. But the moving party must satisfy the court that relief is needed. *The necessary determination is that there exists some cognizable danger of recurrent violation*, something more than the mere possibility which serves to keep the case alive." (Emphasis added)

The Commission's Decision

"Respondent's position here would necessitate that having shown a violation, complaint counsel then demonstrate by affirmative evidence the likelihood of future additional violations. To the contrary, we think the violation is itself the best evidence of the possibility of future such occurrences, and that the burden rests with respondent to demonstrate that violations will not recur before consideration may be given to omitting an order." p. 12, A160.

The Commission's decision transfers the burden of proof from the moving party to the respondent; makes the fact of a past violation *ipso facto* grounds for injunctive relief; and substitutes the standard of a "possibility of future such occurrences" for the *Grant* standard that there must exist "some cognizable danger of recurrent violation." In fact,

Grant specifically rejected the "possibility" standard adopted by the Commission in this case.⁷

The *Grant* case involved a much more serious violation of Section 8 than occurred here. The offending director participated in three separate illegal interlocks, failed voluntarily to terminate these interlocks during five years of administrative attempts to persuade him of their illegality, refused to concede that the interlocks in question were illegal and failed to promise not to commit similar violations in the future. Even so, the district court refused the government's request for injunctive relief, concluding that there was not "the slightest threat that the defendants will attempt any future activity in violation of Section 8 [if they have violated it already] . . ." 112 F. Supp. 336, 338." (345 U.S. at 630-31). While the Supreme Court remarked that, "[w]ere we sitting as a trial court, this showing [the facts of *Grant*] might be persuasive" (emphasis added) (345 U.S. at 634), it nonetheless affirmed the district court's exercise of discretion. Of course, the facts of the present case cannot even compare in gravity to those of *Grant*. Here, the Commission itself accepted as in the public interest a relatively limited consent order as to Bond.

Of particular interest in *Grant* was the Supreme Court's treatment of the government's request for injunctive relief against the corporations which, like SCM here, were each accused of having only one illegal interlock. The Court wrote:

"None of the corporations appeared to have engaged in more than one alleged violation. And affidavits

7. As recognized by the Supreme Court in *Grant*, it is particularly important that the traditional standards for injunctive relief be adhered to in Section 8 cases. No proof of an anti-competitive effect is required to prove a violation of Section 8. Therefore, if the Commission's view that no showing other than a violation is required for injunctive relief, injunctions will routinely issue in all Section 8 cases.

filed with the motions to dismiss indicated that these defendants were ignorant of the Government's interest in the interlocks until the suits were filed. . . . The failure to point to circumstances compelling further relief against the corporations speaks for itself." (345 U.S. at 635).

In the present case, the Staff introduced no evidence of "some cognizable danger of recurrent violation" and did not even allege in the complaint such a danger (A12-17). Instead, the Staff took the position that "[t]he fact that a violation has been committed is a sufficient threat of future misconduct to warrant the Commission's entry of an order forbidding similar and related violations." (Complaint Counsel's Brief on Appeal to the Commission, p. 22). On the question of who bears the burden of proof, the Staff took the position, contrary to the express holding of *Grant*, that "once a violation has been proven, the burden is on the respondent to establish that an order to cease and desist is unnecessary." (Complaint Counsel's Brief on Appeal to the Commission, p. 22).

The ALJ disregarded *Grant* and accepted *in toto* the Staff's argument, holding that the Staff need prove nothing beyond the fact of a violation to warrant injunctive relief (Initial Decision, pp. 15-16, A133-134), that respondent bears the burden of showing facts and circumstances making injunctive relief unnecessary (Initial Decision, p. 14, A132), and that policy considerations favoring strict enforcement of Section 8 coupled with the Commission's "traditional" policy of enjoining future violations even where "it is certain that the precise acts involved in a case could not be repeated" justified injunctive relief here (Initial Decision, p. 16, A134). In so holding, the ALJ erred as a matter of law. In its opinion, the Commission adopted the ALJ's conclusion and reasoning on this point

(Opinion of the Commission, p. 10, A158), compounding the error.

Acceptance of the Commission's opinion in this regard would not only subvert the Supreme Court's explicit holding in *Grant* but would, for all future Section 8 cases, create a presumption in favor of the issuance of an injunction. The administrative agency would be under no obligation to introduce any evidence, other than the fact of a violation at some time in the past, to support the grant of injunctive relief. The absurdity of such a rule of law is patently obvious.

The Commission's Staff argued below that *Grant* has somehow been undermined by subsequent Supreme Court cases. Specifically, the Staff cited *United States v. Concentrated Phosphate Export Assn.*, 393 U.S. 199 (1968), for the proposition that a defendant bears the burden of showing that injunctive relief is unnecessary. That case did cite to *Grant* and did refer to defendants' burden of showing that the likelihood of future violations was remote but it did so in the context of defendants' assertion of mootness as an affirmative defense.⁸ The *Phosphate* case says nothing about what a plaintiff must show to obtain injunctive relief.

Far from overruling *Grant* on the question of the standard for granting injunctive relief, the Supreme Court has explicitly reaffirmed its holding in *Grant*. In *Rondeau v. Mosinee Paper Corp.*, 422 U.S. 49 (1975), the Court reversed a Court of Appeals holding that it was not neces-

8. The Staff has persistently confused the issue of who bears the burden of proof by citing interchangeably cases dealing with, on the one hand, the burden of proving the need for injunctive relief and, on the other hand, the burden of proving mootness as an affirmative defense. *Grant* itself articulated the difference: "[T]he moving party must satisfy the court that [injunctive] relief is needed," but "The case may nevertheless be moot if the defendant can demonstrate that 'there is no reasonable expectation that the wrong will be repeated.'" 345 U.S. at 633.

sary to show irreparable harm as a prerequisite to obtaining injunctive relief. The Court wrote:

"The narrow issue before us is whether this record supports the grant of injunctive relief, a remedy whose basis 'in the federal courts has always been irreparable harm and inadequacy of legal remedies.' *Beacon Theatres, Inc. v. Westover*, 359 U.S. 500, 506-507 (1959)."

* * * *

"[T]he usual basis for injunctive relief, 'that there exists some cognizable danger of recurrent violation,' is not present here. *United States v. W. T. Grant Co.*, 345 U.S. 629, 630 (1953). See also *Vicksburg Waterworks Co. v. Vicksburg*, 185 U.S. 65, 82 (1902)." (422 U.S. at 57 & 59).

While *Rondeau* was a private injunctive action and involved the securities laws rather than the antitrust laws, the private plaintiffs raised, and the Court rejected, many of the same arguments advanced by the Staff in support of injunctive relief here.

(1) The argument was made that "the bare fact that petitioner violated the Williams Act justified entry of an injunction against him."⁹ The Court rejected this argument, writing:

"This position would seem to be foreclosed by *Hecht Co. v. Bowles*, 321 U.S. 321 (1944). There, the administrator of the Emergency Price Control Act of 1942 brought suit to redress violations of that statute. The fact of the violations was admitted, but the District Court declined to enter an injunction because they were inadvertent and the defendant had taken immediate steps to rectify them. This Court held that such an exercise of equitable discretion was proper despite § 205(a) of the Act, . . . which pro-

9. This was precisely the position taken by the Staff on appeal to the Commission.

vided that an injunction or other order 'shall be granted' upon a showing of violation, observing:

'We are dealing with the requirements of equity practice with a background of several hundred years of history. . . . *The historic injunctive process was designed to deter, not to punish.* The essence of equity jurisdiction has been the power of the Chancellor to do equity and to mould each decree to the necessities of the particular case. Flexibility rather than rigidity has distinguished it. The qualities of mercy and practicality have made equity the instrument for nice adjustment and reconciliation between the public interest and private needs as well as between competing private claims. We do not believe that such a major departure from that long tradition as is here proposed should be lightly implied.' 321 U.S., at 329-330. (Emphasis added.)" (422 U.S. at 60-61).

2. The respondent in *Rondeau* also argued, as does the Staff in this case, that the "public interest" required the granting of injunctive relief. Once again the Supreme Court disagreed, holding:

"[I]t by no means follows that the plaintiff in such an action is relieved of the burden of establishing the traditional prerequisites of relief. Indeed, our cases hold that quite the contrary is true." (citations omitted)

* * * *

"[T]he fact that respondent is pursuing a cause of action which has been generally recognized to serve the public interest provides no basis for concluding that it is relieved of showing irreparable harm and other usual prerequisites for injunctive relief." (422 U.S. at 63 & 64-65).

The *Grant/Rondeau* standard for granting injunctive relief has been consistently followed by this Court and in

other circuits. In *SEC v. Management Dynamics, Inc.*, 515 F.2d 801, 807 (2d Cir. 1975), this Court wrote:

"But such illegal activity, without more, does not automatically justify issuance of an injunction. . . . We have . . . held that the critical question in issuing an injunction is whether 'there is a reasonable likelihood that the wrong will be repeated.' *SEC v. Manor Nursing Centers, Inc.*, 458 F.2d 1082, 1100 (2d Cir. 1972)." (other citations omitted).

Accord, Chris-Craft Industries, Inc. v. Piper Aircraft Corp., 480 F.2d 341, 405-06 (2d Cir.), *cert. denied*, 414 U.S. 910, 924 (1973). *See Smith v. Civil Service Commission*, 520 F.2d 731, 734 (7th Cir. 1975).

In the present case, the Staff had its opportunity to submit evidence that SCM would commit a recurrent violation but elected not to do so and, instead, relied exclusively on the fact of a past violation to support its claim for injunctive relief. *Grant* and *Rondeau* make clear that that is not enough.

Brief mention should also be made of the ALJ's and Commission's analysis of certain facts, which occurred after the complaint was filed and which the Commission improperly cites as "evidence" that a cease and desist order is warranted. They are: (1) SCM's raising the argument that corporations are not subject to Section 8; (2) SCM's alleged failure to give "adequate assurances of voluntary compliance"; and, (3) SCM's so-called silence "on what steps it has taken to avoid the danger of other unlawful interlocks." (Initial Decision, pp. 14 & 16, A132 & 134; *see* Opinion of the Commission, pp. 10 & 11, A158-159). None of these points constitutes *evidence* of a danger of recurrent violation sufficient to justify issuance of a cease and desist order.

In the first place, all of these so-called facts relate to post-complaint behavior by SCM. It is fundamentally unfair to characterize arguments that a respondent raises in

its defense and actions that a respondent takes in the hope of achieving a voluntary and informal disposition of the matter as "evidence" of the need for a cease and desist order. If anything, they are illustrative of a respondent's good faith belief that it has meritorious defenses but is nonetheless willing to consider a reasonable disposition. The logic of the Commission's analysis is that any respondent who raises legal defenses to the Commission's demand for broad injunctive relief, or offers assurances on terms less than originally demanded by the Staff, must be unwilling to comply fully with the law and, therefore, can and should be subjected to a cease and desist order. Suffice it to say that such *a priori* reasoning does not rise to the level of *evidence* warranting injunctive relief.¹⁰

The suggestion that SCM should be subjected to a broad cease and desist order because it failed to give what the Commission termed "adequate assurances of voluntary compliance" and because of its so-called silence "on what steps it has taken to avoid the danger of other unlawful interlocks" is particularly disingenuous. As early as November 16, 1975, seven months before the ALJ's initial decision, SCM voluntarily represented "that Mr. Bond will not be re-elected to the Board of Directors of SCM so long as he is a director of Krafteo or any corporation which competes or might compete in any line of commerce with SCM." (Sexton Aff., para. 10, A32-33.)

Since the Commission commenced this proceeding because of Bond's simultaneous service on the boards of directors of SCM and Krafteo, SCM reasonably believed that the above assurance was more than adequate to meet the Commission's concerns. Regardless of whether SCM

10. Similarly, the Staff's suggestion, that because SCM has argued that Section 8 does not apply to corporations it will not voluntarily obey the law in the future, is hardly a basis for injunctive relief. The Commission itself recognized that even SCM's past violation was not intentional. (Opinion of the Commission, p. 10, A158).

was right or wrong in this belief, the critical point is that the Staff never asked SCM for a broader representation or even suggested that anything less than a cease and desist order would be acceptable. Moreover, it is noteworthy that SCM's representation of November 16, 1975, closely parallels the Bond consent order (A59-61). Since the Commission itself accepted that order as being in the public interest, it is not readily apparent why substantially the same promises by SCM were less so.

The only "silence" that is relevant to the disposition of this case is the "silence" of the record as to any evidence of "some cognizable danger of recurrent violation." The Commission had no evidence to offer on this issue and instead relied on the erroneous theory that proof of a past violation automatically warrants future injunctive relief. We respectfully suggest that the Commission has left this Court with no alternative but to vacate the order.

II.

Only an Individual Director, And Not the Corporation on Whose Board He Serves, Can Violate Section 8 of the Clayton Act.

The statutory prohibitions of Section 8 are aimed at the director, not the corporation. Section 8 of the Clayton Act, 15 U.S.C. § 19, provides in relevant part:

"No person at the same time shall be a director in any two or more corporations, any one of which has capital, surplus, and undivided profits aggregating more than \$1,000,000, engaged in whole or in part in commerce, other than banks, banking associations, trust companies, and common carriers subject to the Act to regulate commerce, approved February fourth, eighteen hundred and eighty-seven, if such corporations are or shall have been thereto-

fore, by virtue of their business and location of operation, competitors, so that the elimination of competition by agreement between them would constitute a violation of any of the provisions of any of the antitrust laws. The eligibility of a director under the foregoing provision shall be determined by the aggregate amount of the capital, surplus, and undivided profits, exclusive of dividends declared but not paid to stockholders, at the end of the fiscal year of said corporation next preceding the election of directors, and when a director has been elected in accordance with the provisions of this Act it shall be lawful for him to continue as such for one year thereafter."

The clear language of the statute and its legislative history demonstrate that its substantive prohibition applies only to individual directors and not to the corporations on whose boards the directors serve.¹¹

The statute provides that "[n]o person at the same time shall be a *director* . . ." It does not provide that a corporation is prohibited from electing a director who is also a director of a competitor. Congress could have imposed liability on both the individual director and the corporation on whose board he serves, but it chose not to do so. That this decision was a considered one, not lightly to be disturbed by judicial construction, is evident from Section 8's legislative history.

In its original form as enacted, Section 8 included specific statutory language imposing direct liability on banking corporations for violation of the statute. 38 Stat. 732-33¹²

11. In *Grant*, 345 U.S. at 634 n. 9, the Supreme Court reserved decision of this question:

"We should not be understood as deciding whether corporations can violate § 8 or, for other reasons, be enjoined under the statute."

12. The language providing for the direct liability of banking corporations was eliminated by amendment in 1935. 49 Stat. 718.

Significantly, no such direct corporate liability was provided with respect to either common carriers or commercial and industrial corporations. Had Congress intended that Section 8 impose liability on common carriers and commercial and industrial corporations, as well as individual directors, it could have simply used the same language that it did use as to banking corporations. That Congress chose to treat commercial and industrial corporations differently, for whatever reason, is a legislative choice not lightly to be disturbed. Moreover, when Congress amended Section 8 in 1935 by deleting the language imposing direct liability on banking corporations, it again evidenced its intent not to subject corporations, as distinct from individual corporate directors, to Section 8 liability. 49 Stat. 718.

The committee reports accompanying passage of Section 8 further support the conclusion that its substantive prohibitions were aimed at individual directors and not at corporations. As stated in the majority report on the House bill:

"The concentration of wealth, money and property in the United States under the control and in the hands of a few *individuals* or great corporations has grown to such an enormous extent that unless checked it will ultimately threaten the perpetuity of our institutions. The idea that there are only a few *men* in any of our great corporations and industries who are capable of handling the affairs of the same is contrary to the spirit of our institutions. From an economic point of view, it is not possible that one *individual*, however capable, acting as a director in fifty corporations, can render as efficient and valuable service in directing the affairs of the several corporations under his control as can fifty capable men acting as single directors and devoting their entire time to directing the affairs of one of such corporations." H.R. Rep. No. 627, Part 1, 63d Cong., 2d Sess. 19-20 (Emphasis added).

The same inference can be drawn from the minority reports. The minority views of Rep. Graham, favoring less stringent legislation, focus on whether the existing laws punishing *directors* are strong enough or whether they need reinforcement. H.R. Rep. No. 627, Part 2, 63d Cong., 2d Sess. 2011. And the minority view of Rep. Nelson, favoring more stringent legislation, was:

"The other provisions of this section similarly aim at a form of the evil of interlocking control and not at the evil itself. *Persons are prohibited* from acting at the same time as directors, officers, or employees of two corporations of certain classes. Yet it permits these corporations to be controlled by the same man or the same set of men, if they but exercise their control through some other manner than that of interlocking directors. . . . A form of the evil only is prohibited; but the evil itself may still prevail." H.R. Rep. No. 627, Part 3, 63d Cong., 2d Sess. 9 (Emphasis added).

In its opinion, the Commission conceded that "the language of Section 8 read *in vacuo* perhaps leaves some doubt as to the entities its proscription is intended to cover." (Opinion of the Commission, p. 5, A153). The context in which the Commission held Section 8 must be read, and in which the Commission concluded that Section 8 does apply to corporations as well as individual directors, was Section 11 of the Clayton Act.¹³ In articulating certain of the

13. Section 11(b) of the Clayton Act provides in pertinent part:

"If upon such hearing the Commission or Board, as the case may be, shall be of the opinion that any of the provisions of said sections have been or are being violated, it shall make a report in writing, in which it shall state its findings as to the facts, and shall issue and cause to be served on such person an order requiring such person to cease and desist from such violations, and divest itself of the stock, or other share capital, or assets, held or rid itself of the directors chosen contrary to the provisions of sections 18 and 19 of this title [Clayton Act §§ 7 & 8], if any there be, in the manner and within the time fixed by said order."

remedies available when the Clayton Act has been violated, Section 11 includes a cease and desist order requiring the respondent to "rid itself of the directors chosen contrary to the provisions of [Sections 7 and 8 of this Act]." Reasoning that "only a corporation may 'rid itself' of directors" (A153), the Commission concluded that Section 8, and not just Section 11, applies both to individual directors and to corporations.

There are several reasons why the Commission's use of Section 11 language to find a substantive liability against corporations under Section 8 is in error. First, Section 11 is exclusively a procedural provision creating in itself no substantive obligations. Even if Section 11 could be read so as to conclude that a corporation can violate Section 8, it follows that the relief available against a corporation for such a violation is limited by the same provision of Section 11 used to infer the liability—i.e.—to a cease and desist order requiring the corporation to "rid itself" of the offending director. Since Bond voluntarily resigned on August 1, 1975, the question of relief against SCM is academic. Clearly Section 11 offers no predicate for the broad prospective injunction entered here.

Second, a good indication that Section 11's "rid itself" language should not be read so broadly as to infer therefrom a substantive liability against corporations under Section 8 is the further language of Section 11 to the effect that the Commission's cease and desist power applies only to persons "subject to" the substantive liability Sections of the Act. The issue then becomes whether SCM is "subject to" the liability provisions of Section 8 and, as is apparent, the question has come full circle. The circularity of reasoning engendered by any attempt to use the procedural provisions of Section 11 as a predicate to find a new substantive liability under Section 8 recommends its own rejection.

Third, the most logical explanation for the "rid itself" language of Section 11 comes from the Clayton Act's legislative history. As recited *supra*, when Section 8 was originally enacted, Congress explicitly imposed a substantive liability on banking corporations. While that liability provision was operative, the "rid itself" language of Section 11 served a practical function—empowering the Federal Reserve Board to order a banking corporation to "rid itself" of offending directors. But, when the liability provision was eliminated from Section 8 by amendment in 1935 (49 Stat. 718), the "rid itself" language of Section 11 became only a vestigial remainder—hardly a basis for creating, sixty-three years later, a new substantive liability under Section 8.

Each of the above reasons argues strongly against the Commission's holding that Section 8 imposes a substantive liability on commercial and industrial corporations, like SCM, merely because a separate procedural section of the same Act still contains language that lost its operative effect in 1935. But, even if one were to accept the Commission's viewpoint that the "rid itself" language of Section 11 has current vitality, it does not follow that Section 8 must therefore impose substantive liability on corporations as well as on individual directors. A more reasonable construction is that a corporation, although not itself in violation of Section 8, may be subject to a Section 11 order to "rid itself" of an offending director if that director refuses voluntarily to resign.¹⁴ Such a construction is

14. This construction is suggested in Kramer, "Interlocking Directorships and the Clayton Act After 35 Years," 59 YALE L.J. 1266, 1268 n. 12:

"Assuming that he [the unlawful interlocking director] is [liable under Section 8], are either of the corporations which elected him to its board also violating Section 8? In any event, they can probably be named as defendants and an injunction obtained against one of them prohibiting it from allowing [the director] to continue to serve on its board. See Section 11. . . ."

entirely consistent with both the language of Sections 8 & 11 and with the Congressional purpose of preventing an individual from simultaneously serving on the boards of directors of competing corporations. At least one district court has given tacit approval to this construction of the "rid itself" language of Section 11. In *United States v. Crocker National Corp.*, 422 F. Supp. 686, 705-06 (N.D.Cal. 1976), the Court wrote:

"Regardless of whether this contention [that Section 8 does not apply to corporations] is correct, it is clear, and the defendants conceded at oral argument, that were this court to decide that injunctive relief were appropriate in these cases, this court could, if it chose to, enjoin the defendant corporations, as well as the individual defendants from further violating Section 8. *See e.g.*, 15 U.S.C. § 25."¹⁵

It is difficult to comprehend the policy arguments, advanced by the Commission in its opinion, pp. 6-7, A154-155, as justification for subjecting a corporation to substantive liability under Section 8. All of these policy goals, even assuming their validity, can be achieved by the narrower interpretation of Section 11 adopted by the Court in *Crocker*. Here, of course, there is no occasion for issuance of a Section 11 "rid itself" order, even if this Court were to hold that the Commission has the power to issue such an order against a corporation, as Bond voluntarily resigned from SCM in August of 1975.

15. *See* Wilson, "Unlocking Interlocks: The On-Again Off-Again Saga of Section 8 of the Clayton Act", 45 ANTITRUST L. J., Issue 2, 317, at 322-23.

III.

The Federal Trade Commission Cannot Be Permitted To Use Section 5 of the FTC Act As a General License To Regulate Whomever and Whatever It Chooses.

In an apparent effort to expand the scope of its regulatory powers, the Staff has insisted that SCM violated not only Section 8 of the Clayton Act but also Section 5 of the FTC Act. The Staff argued on appeal to the Commission that "SCM may be held liable for a violation of Section 5 even if, *arguendo*, Section 8 is not applicable to corporations . . ." (Complaint Counsel's Brief on Appeal to the Commission, p. 15). The Commission adopted the Staff's position, writing:

"Assuming *arguendo* that illegally interlocked corporations must be allowed to escape liability through the allegedly porous wording of Section 8, no better illustration of a practice offensive to the spirit and policy of the antitrust laws if not their letter can be imagined than the employment and retention by a corporation of a director whose presence on the board itself violates the law. Application of Section 5 in such a case does no more than effectuate the clear purpose of the Clayton Act." (Opinion of the Commission, p. 7, A155).¹⁶

The Commission's attempt to extend its regulatory powers by interpreting Section 5 as an unlimited license from Congress to legislate new and different violations of the antitrust laws runs afoul of established limitations on administrative discretion. *E.g.*, *United States v. George*, 228 U.S. 14 (1913); *Reid v. Memphis Publishing Co.*, 521

16. The Commission's decision to invoke Section 5 of the FTC Act was not shared by all four of its participating members. Chairman Collier, separately concurring, wrote: ". . . I find it unnecessary to reach the question whether the director interlock in question violated Section 5 of the Federal Trade Commission Act." (A148)

F.2d 512 (6th Cir. 1975) (and cases cited therein). Nor can it be permitted by characterizing it, as did the Staff in its brief on appeal to the Commission, as "merely filling a minor gap in Section 8 to ensure that Congress' purpose was accomplished." (Complaint Counsel's Brief on Appeal to the Commission, p. 17).

Section 8 of the Clayton Act was enacted by Congress as a comprehensive legislative scheme to regulate the perceived problem of interlocking directorates. As the legislative history cited in Point II indicates, Section 8 as finally enacted was the result of numerous legislative compromises. If the bill that finally passed both Houses of Congress was less comprehensive than it could have been, or even if there were gaps in its coverage, its scope was what Congress intended it to be. For the FTC, sixty-three years later, to ignore limitations built into the statute by Congress under the purported authority of another statute that gives the Commission a general power to proscribe "[u]nfair methods of competition in or affecting commerce, and unfair or deceptive acts or practices in or affecting commerce" is to exalt administrative discretion over legislative decision. Acceptance of the Commission's viewpoint would make all of the antitrust laws except Section 5 surplusage. Clearly Congress could not have intended such a perverse result when it enacted Section 5 of the FTC Act.

In support of its "filling the gap" argument, the Staff cited *Grand Union Co. v. FTC*, 300 F.2d 92 (2d Cir. 1962). In that case this Court held that Section 2(d) of the Robinson-Patman Act, 15 U.S.C. § 13(d), applied to buyers who solicited illegal payments as well as to suppliers who gave them. In so holding, this Court wrote:

"[T]he Commission is not here utilizing § 5 to create a substantive extension of the Clayton Act. We do not agree that the Commission's opinion here represents an attempt to 'supply what Congress has studiously omitted.'"

"Nor can we accept the notion that the Commission is here legislating a 'new antitrust prohibition.' . . . The Commission is not upsetting specific Congressional policies; the proceedings did not 'circumvent the essential criteria of illegality prescribed by the express prohibitions of the Clayton Act.'" (300 F.2d at 98).

In holding that § 5 extended to "buyers" under the facts of the *Grand Union* case, this Court was careful to delineate several limitations to its holding. (1) This Court noted that the Commission in *Grand Union*, unlike in the present case, was not attempting to use § 5 to reach activities specifically regulated by another provision of the anti-trust laws.

"If the Commission were proceeding against petitioner under § 5 solely because its activities contravened § 2(f), there might be a question of the propriety of utilizing the vague language of § 5 rather than the precise standards of the Clayton Act. It has been suggested that § 5 'should *not* be invoked whenever the transaction in question is governed by specific provisions in the Clayton Act.'" (footnote omitted) (300 F.2d at 95.)

(2) The Court recognized the danger that "under the Commission's rule in this case it could supply omissions in the Clayton Act left by Congress for a specific purpose", but held that this concern was inapplicable in *Grand Union* because "there seems to be no specific reason why Congress omitted buyers from the coverage of § 2(d), while including them under § 2(c) and (f); the omission was more 'inadvertent' than 'studious'." (300 F.2d at 96).¹⁷ (3) In light of the uncertainty of the law as to whether § 2(d) of the

17. Here, the legislative history of Section 8, outlined in Point II *supra*, demonstrates that the decision to exclude commercial and industrial corporations from substantive liability under Section 8 was not "inadvertent."

Robinson Patman Act applied to "buyers", this Court stated that one reason why it ultimately applied § 5 in *Grand Union* was because "[t]he Commission . . . correctly limited the complaint to 'knowing receipt or inducement' of disproportionate payments." (300 F.2d at 100). This Court properly recognized the unfairness of finding a respondent in violation of a general provision of the antitrust laws because of unintentional conduct which could reasonably have been considered by such respondent as left uncovered by the specific statute regulating that general class of conduct. Here, the Commission itself noted that SCM's alleged violation was unintentional. (Opinion of the Commission, p. 10, A158).¹⁸

Each of the factors, identified by this Court in *Grand Union* as limiting the extent to which the FTC can use Section 5 to "fill the gap" in other provisions of the antitrust laws, argues against upholding the Commission's use of Section 5 under the facts of this case. Here, the express language of Section 8 of the Clayton Act and its legislative history, discussed in Point II *supra*, makes it evident that Congress did not intend to subject corporations (especially those like SCM that did not intentionally violate the Act) to substantive liability. If anything, *Grand Union* supports SCM's argument that regulatory schemes carefully

18. Despite the limitations imposed by the majority in *Grand Union* on the scope of its holding, Judge Moore dissented and expressed his strong disagreement with any holding:

"that the Federal Trade Commission can arrogate to itself the legislative powers of Congress whenever there appears a field which Congress has not covered but which the Commission believes should be covered by legislation of its own making."

* * * * *

"If, however, the Commission under Section 5 has such broad unlimited powers to fill in assumed omissions, then 'the specific acts of Congress in the antitrust field which the Commission administers are essentially superfluous.'" (citation omitted) (300 F.2d at 101 & 103).

delimited by Congress should not be expanded beyond their intended contours.¹⁹

While the disruption of the regulatory scheme of Section 8 is a sufficient reason in itself to reject the Commission's attempt to use Section 5 as a blunderbuss to reach all interlocking directorates, there are additional reasons for rejecting the Commission's position.

First, there was no evidence that Bond's simultaneous service on SCM's and Krafco's boards had any effect whatsoever on competition between the two companies. Having tried this case before the Commission on the theory that a violation of Section 8 was conclusively proved and that no further evidence was required to support issuance of a cease and desist order, the Staff supplied no evidence of an anticompetitive effect.²⁰

19. One commentator analyzed the FTC's recent attempts to reach interlocking directorates under Section 5 of the FTC Act as follows:

"[T]he FTC is obviously relying upon the line of cases which uphold the broad reach of Section 5 of the FTC Act to plug inadvertent loopholes or to prohibit unfair practices not otherwise outlawed by the antitrust laws.⁴³ Unregulated interlocks, however, are not inadvertent loopholes, but the result of a selective and discriminating legislative approach to the general problem of interlocks. If the FTC's plug-the-loophole concept is upheld, such discriminating legislative choices could be wholly frustrated."

⁴³ The broad application of Section 5 of the FTC Act could also frustrate specialized regulation of interlocks by those agencies specifically assigned with supervisory jurisdiction over various banking institutions." Wilson, "Unlocking Interlocks: The On-Again Off-Again Saga of Section 8 of the Clayton Act," 45 Antitrust L. J., Issue 2, 317, at 327.

20. Mr. Wilson wrote: "Unfortunately, the FTC's complaints continue to invoke Section 5 as if it were a per se prohibition requiring no showing whatever of competitive effect. [footnote omitted] Expanding Section 5 into a per se prohibition of all interlocks would be unwise even if it could be upheld as a legal matter." 45 Antitrust Law Journal, Issue 2, at 329.

Second, SCM's having had on its board a director who was in violation of Section 8 does not constitute a "method of competition" or an "act or practice" within the meaning of Section 5(a)(1). The latter terms imply a *deliberate* course of conduct or act, which the Commission itself conceded was not shown to be the case here—"[SCM] probably did not intend to use [interlocked directorates] when it hired Mr. Bond. . . ." (Opinion of the Commission, p. 10, A158).

Lastly, for the Commission to issue a cease and desist order under Section 5, such an order must be found to be in the public interest. Here, Bond resigned on August 1, 1975, and the Commission has offered no reason why the public interest requires SCM to be subjected to a cease and desist order.

In a case in which the Commission's cease and desist order is supported by no record evidence, where there is no apparent reason why the public interest requires an injunctive order and where the practice in question is already comprehensively regulated by another statute, it seems inappropriate for this Court in this case to uphold the Commission's position that it is empowered by Section 5 to regulate interlocks left unregulated by Congressional decision under Section 8.

IV.

The FTC's Discriminatory Enforcement of Section 8 Against SCM Bars Issuance of a Cease and Desist Order

The FTC's enforcement of Section 8 has not been even-handed. Over the years the Commission followed the procedure of informing a director believed to be involved in an interlock and the corporations on whose boards he served of a potential legal challenge, and in many cases accepted a voluntary resignation as grounds for closing the matter.

Yet here, without any pretense at justification, the Commission gave SCM no advance notice of its objection to Bond's Krafteo/SCM directorships, filed its complaint and then demanded a broad prospective cease and desist order even after Bond's voluntary and immediate resignation. When SCM contested the Commission's right to prospective injunctive relief, this was used as the foundation for the entry of an even more burdensome prospective order than the Commission had found to satisfy the public interest with respect to Bond and Krafteo.

The Commission's arbitrary action here is contrary to its statutory mandate and effectively denies to SCM due process and equal protection of the laws.

A. The Commission's Refusal To Accept SCM's Assurances of Future Section 8 Compliance Is Inconsistent With the FTC's Enforcement Policies.

The enforcement history of Section 8 of the Clayton Act has been checkered at best.

"Looking back over 60 years of enforcement under Section 8, we find the FTC and Justice Department lacking any discernible policy with regard to interlocks as enforcement has seemingly drifted with a few peaks and many valleys."

* * * *

"Both the Department of Justice and Federal Trade Commission, in their enforcement of Section 8 of the Clayton Act, have pursued a policy on director interlocks which has been punctuated by a few bursts of mild activity and then followed by long periods of benign neglect." 45 Antitrust Law Journal, Issue 2, at 315 (remarks of Melvin Goldman) & 317 (remarks of J. Randolph Wilson).²¹

21. The Commission's traditional policy of closing a case upon the voluntary resignation of the offending director comported well with the Supreme Court's directive in *Grant* that injunctions should only issue when there is "some cognizant danger of recurrent violation." Why the Commission abandoned this policy in favor of "routinely" issuing cease and desist orders is not explained.

SCM raised the issue of Section 8's uneven and discriminatory enforcement as a defense in its answer. (A26-27). During the course of the administrative proceeding, the Staff in response to SCM's request, provided certain information about the FTC's Section 8 investigations since 1960. This information was embodied in the Stipulated Record, A62-116. Of the 31 Section 8 investigations on which information was provided,²² a complaint issued in only 10 cases. Even more significantly, all of the 10 complaints that did issue were under Part II of the Commission's Rules—not Part III under which the complaint against SCM was issued.²³ SCM was the first, or one of the first, corporations since at least 1960 to have a Part III complaint issued against it in a Section 8 investigation.²⁴

A further aspect of the FTC's discriminatory treatment of SCM stems from the fact that SCM was given no advance notice that it was being investigated—let alone that a complaint would be issued. By contrast, in 27 of the 31 FTC investigations under Section 8 since 1960 (for which information was provided) the respondent was notified that an investigation *of it* was pending prior to issu-

22. While the Staff provided SCM with 42 summaries of Section 8 proceedings, not all of these summaries described different cases.

23. Certain of the ALJ's fact findings provide further evidence of the uneven enforcement of Section 8 by the Commission.

"It is true that between 1960 and 1966, the Commission closed eleven Section 8 investigations after termination of the offending interlocks, and that in none of the pre-1966 cases was a formal consent order executed." (Initial Decision, p. 11, A129).

24. Under Part II, it was the practice of the Commission to issue a "proposed complaint" "for the purpose of encouraging consent settlements before a formal complaint was issued." (Initial Decision, p. 12 n.21, A130). Under Part III, a formal complaint issues immediately and the respondent therefore is not afforded an opportunity to avoid issuance of a formal complaint by entering into a consent settlement.

ance of a formal complaint.²⁵ And, of the 4 cases in which no advance notice was given, 3 were "[c]losed by the Commission in response for a request for compulsory process." (Stipulated Record, Exhibit A, Nos. 711 0063, 731 0024 & 731 0031, ASS, 90 & 91). It is readily apparent, therefore, that in addition to being the target of the FTC's first Part III complaint issued in at least 15 years, SCM was the only respondent not given advance notice of the pendency of an investigation against it.

The ALJ concluded that SCM's charges of discrimination in the manner in which the FTC's complaint was issued against it were groundless for the following reasons: (1) "After April 4, 1975,²⁶ all complaints (including this one) were issued under Part 3" (A130); (2) "[I]n all formal complaint proceedings initiated since 1972, *corporate* respondents have routinely been required to enter into consent agreements even though the interlocks have been terminated" (129); (3) SCM was not prejudiced by the change of procedure since it could have entered into a consent settlement after issuance of the formal complaint (A130).²⁷ Each of these points is in error.

(1) Even if the Commission did change its rules on April 4, 1975, to eliminate Part II complaints, it does not follow that it was proper to issue a Part III complaint against SCM on July 22, 1975. It is clear from the record that the investigation of SCM began at least as early as March 7,

25. The pre-formal complaint notification took the form of either an informal communication or a Part II pre-complaint.

26. On April 4, 1975, the FTC issued revised rules. 40 Fed. Reg. 15235.

27. In its Opinion on appeal, the Commission characterized SCM's discrimination arguments as "patently frivolous", treated with them in one footnote and ultimately adopted the reasoning of the ALJ (Opinion of the Commission, p. 14 n.7, A162).

1975.²⁸ At that time, the Commission exclusively used the Part II, informal complaint procedure. Since SCM was subjected to an investigation which at the time it was conducted looked only to a Part II complaint, it was a denial of SCM's right to due process for the Commission conveniently to change its rules and then issue a Part III complaint against it. While the Commission undoubtedly has a right to change its rules of procedure, it cannot change horses in midstream by altering rules of procedure (to its own benefit and a respondent's disadvantage) in the middle of an on-going investigation.²⁹

(2) The fact that corporate respondents since 1972 have been "routinely" required to enter into consent orders says nothing to counter SCM's discrimination argument. Those respondents were given an opportunity to work out favorable consent settlements before a formal complaint issued. In fact, the Staff stipulated that "[p]rior to 1975, the Commission usually followed the practice of issuing a Part II complaint prior to issuance of a Part III or final com-

28. Mr. Sexton stated in his affidavit that he received a telephone call from Mr. Batterton of the Commission staff on March 7, 1975 (Sexton Aff., para. 8, A31-32). While Mr. Sexton was not informed at that time that SCM was under investigation for a possible violation of Section 8, it is apparent from the Staff's arguments in this case that SCM was in fact under investigation at that time.

29. Indeed, the Commission's issuance of a formal complaint against SCM in July of 1975 was in derogation of the Commission's statement of policy accompanying its change of rules in April of 1975.

"This decision [to issue Part III complaints following future investigations] does not affect the Commission's policy of encouraging settlements and discouraging litigation where a consent agreement is in the public interest. Opportunity to negotiate such agreements will continue to be available during the investigative stage, and, in appropriate circumstances, after complaint has issued." 40 Fed. Reg. 15235.

Here, SCM was given no opportunity to negotiate a consent agreement during the investigatory stage, as it was not even informed that an investigation was in progress until the complaint issued.

plaint." (Emphasis added) (A69). SCM was given no such opportunity.

3. Most importantly, the ALJ erred in holding that SCM was not prejudiced by the Commission's proceeding under Part II, rather than Part III, simply because SCM could have entered into a consent settlement after issuance of the formal complaint. The ALJ failed to take notice of the fact that, after the complaint was issued, the Staff was unwilling to entertain any settlement proposal that did not include a broad cease and desist order.

The clearest example that the Staff's decision (to change its rules and then proceed against SCM by issuance of a formal complaint without advance notice) prejudiced SCM can be found in the Commission's opinion. The Commission explicitly held that one fact properly to be considered as part of the public interest is the amount of time and money the FTC has spent on the case. (Opinion of the Commission, p. 15, A163). By the Commission's own reasoning, therefore, the Staff's decision to deprive SCM of an opportunity to enter into a pre-complaint settlement was necessarily prejudicial because the extra time and money involved in issuing a formal complaint, and ultimately in litigating this proceeding, was charged against SCM in the form of a more severe cease and desist order.

Such arbitrary conduct by the FTC, especially when no effort was made to explain why SCM should be singled out from all other corporations that were investigated for a possible Section 8 violation since at least 1960, constitutes a denial of equal protection. As this court has stated:

"Equal protection of the laws' means more than merely the absence of governmental action designed to discriminate; as Judge J. Skelly Wright has said, 'we now firmly recognize that the arbitrary quality of thoughtlessness can be as disastrous and unfair to private rights and the public interest as the pervers-

sity of a willful scheme.' *Hobson v. Hansen*, 269 F. Supp. 401, 497 (D.D.C. 1967)." *Norwalk CORE v. Norwalk Redevelopment Agency*, 395 F.2d 920, 931 (2d Cir. 1968).

B. The Public Interest Does Not Require, and the Constitution Forbids, Entry of a More Burdensome Cease and Desist Order Against SCM Merely Because SCM Exercised Its Right To a Hearing.

In addition to its departure from usual administrative procedures, the Commission further discriminated against SCM by subjecting it to a cease and desist order substantially more severe than the consent orders entered against Bond and Krafteo for the same alleged violation. The Commission took this action without any record evidence showing a need for SCM to be treated more harshly than its correspondents. And, the only reason given by the Commission in attempted justification of this discrimination is one which unconstitutionally infringes on SCM's due process right to a hearing.

On April 26, 1976, the Commission accepted as in the public interest a consent order as to Richard Bond. (A59-61). On September 9, 1976, the Commission accepted as in the public interest a consent order as to Krafteo. (A139-143). Both the Bond and Krafteo consent orders are substantially less harsh than the cease and desist order imposed by the Commission on SCM.

To understand the substantive differences between the Bond, Krafteo and SCM orders, it is useful to set forth the relevant provisions of these orders in parallel columns. Underlining is used to highlight the most important differences.

Bond Order

1. "Bond, so long as he remains a director of Kraftco . . ., (a) shall not resume his position as a director of SCM . . .; and, (b) shall not accept or . . . hold a position as director of any other corporation engaged in . . . competition with Kraftco. . . ." (A61)

2. [No comparable provision]

Kraftco Order

1. Kraftco must not permit "any individual to serve on its Board of Directors if such individual is . . . at the same time a director of SCM . . . so long as Kraftco and SCM . . . compete." (A141)

2. "[W]ithin ninety (90) days of . . . service of this order and annually in each of the four (4) years thereafter, Kraftco shall transmit to each member of its Board . . . a list of the following products: (a) cheese, (b) fluid milk, (c) ice cream, (d) barbecue sauce, (e) edible oils, (f) margarine, and (g) any product in which Kraftco had sales which accounted for 5% or more of Kraftco's gross revenues in the preceding fiscal year; [and] shall . . . request that each director . . . certify to Kraftco in writing that he . . . does not serve on the Board . . . of any corporation which [competes] with Kraftco in the manufacture or sale in the

SCM Order

1. SCM must not permit on its board "any individual who . . . serves at the same time as a director of Kraftco, . . . so long as Kraftco and SCM . . . compete, . . . or serves at the same time as a director of any other corporation . . . which competes with SCM. . . ." (A146)

2. "[W]ithin thirty (30) days of the effective date of this order [and annually for five (5) years] SCM . . . shall obtain a written statement from each member of its board . . . showing . . . a listing of each product or service produced or sold by each corporation [of] which the director . . . then serves as a director. . . ." (A146-147)

Bond Order

3. [No comparable provision]

4. Bond "shall file with the Commission a written report setting forth the manner and form in which he has complied with this order." [Para. 2 of Bond Order] (A61)

5. [No comparable provision]

Kraftco Order

United States of any product listed by Kraftco where the sales of such product by the corporation . . . exceed \$1,000,000 per year. (A141-142)

3. "[F]or a period [of] five (5) years . . . , Kraftco shall not permit on its Board . . . any . . . director who fails to submit a written certification pursuant to Paragraph II above." (A142)

4. "[For a period of (5) years] Kraftco shall file with the Commission a written report setting forth in detail the manner and form in which it has complied with this order." (A143)

5. "Kraftco [must] notify the Commission . . . thirty (30) days prior to any change [in corporate form]." (A143)

SCM Order

3. "[For a period of five (5) years, SCM] shall not have on [its] board . . . any individual who . . . fails to submit to SCM . . . any statement required by Paragraph Two of this order." [Paras. 1 and 2 of SCM Order]. (A146-147)

4. "[F]or a period of ten (10) years . . . , SCM . . . shall file with the Commission a written report setting forth in detail the manner and form in which it has complied with this order. Copies of the statements obtained pursuant to Paragraph Two of this order shall be submitted to the Commission as part of the reports of compliance required by this Paragraph during the first five (5) years." [Para. 3 of SCM Order] (A147)

5. "SCM . . . shall notify the Commission . . . thirty (30) days prior to any change in the corporation." [Para. 4 of SCM Order] (A147)

It is apparent from a comparison of the above orders that SCM's is the most severe. SCM is enjoined from having as a director any individual who is at the same time a director of any corporation that competes with SCM. Krafteo is enjoined only from having a common director with SCM. The product list that SCM directors must furnish annually must include each product or service produced or sold by any other corporation of which they are directors. The product list required of Krafteo directors is limited to certain product types (generally any product of which Krafteo's sales accounted for 5% or more of its gross revenues) and is further limited by a \$1 million sales provision as to the other corporations on whose boards Krafteo directors serve.³⁰ SCM must file a compliance report for ten years and must also provide the Commission with copies of the statements, including the lists, obtained from SCM directors. Krafteo is only required to file a compliance report for five years and need not transmit to the Commission copies of the limited lists required from its directors.

SCM raised on its appeal to the Commission the argument that the proposed cease and desist order against it was unfair in that it was substantially more severe than the orders entered against Bond and Krafteo.³¹ The Commission rejected SCM's argument for two reasons: (1) It cannot be assumed that Krafteo "violated the law in equal

30. The burdensomeness of the "list" requirement imposed on SCM is readily apparent when one thinks of just how many products and services a large integrated manufacturing company sells.

31. The cease and desist order proposed by the ALJ was even more discriminatory against SCM than the final order of the Commission. While the Commission modified certain provisions of the ALJ's order, it retained other provisions clearly discriminating against SCM.

measure as SCM";³² (2) a factor bearing upon the public interest and justifying a more severe order against SCM is the savings in "time" and "money" realized by Kraftco's settlement and lost by SCM's decision to exercise its constitutional rights to defend against the Staff's charges. (Opinion of the Commission, p. 15, A163). Neither of these so-called reasons justifies the Commission's discrimination against SCM by imposition of a more severe cease and desist order.

Theoretically, the Commission might be correct in its view that just because two corporations share the same director, who is thereby in violation of Section 8, does not mean that the corporations (assuming that they can commit a violation of Section 8 at all) are equally at fault. But here, the Staff has presented no evidence to prove that SCM is more culpable than Bond or Kraftco. The Staff has failed to carry its burden of proving by probative facts that the public interest demands a more severe cease and desist order against SCM than against Kraftco.

The facts which are of record suggest that, if SCM and Kraftco are to be treated differently, the more severe order should have been imposed on Kraftco, not on SCM. Kraftco's sales of products in competition with SCM were over three times SCM's sales in competition with Kraftco. Bond resigned from SCM's board, not Kraftco's. SCM offered voluntary assurances, seven months before the ALJ's initial decision, that Bond would not be re-elected as a director as long as he served on the board of Kraftco or "any corporation which competes or might compete in any line of commerce with SCM." Kraftco made no comparable

32. Particularly disingenuous is the Commission's attempt to buttress its position by reference to Kraftco's disclaimer of liability and the possible difficulties of trial which might justify acceptance of a less severe order as to Kraftco. (Opinion of the Commission, p. 15, A163). SCM's stipulated record, on the FTC's theory of the law, was sufficient proof of a violation by Kraftco as well as by SCM.

representation before entering into a consent order. All of these facts, pointing toward a less rather than a more severe cease and desist order against SCM, were ignored in the Commission's rush to punish SCM for putting it to the trouble and expense of attempting to prove its case.

Particularly troublesome is the Commission's holding that "we believe the Commission does not act improperly when . . . it weighs as part of the requisite public interest the savings in time, money, and uncertainty which the settlement will provide." (Opinion of the Commission, p. 15, A163). In other words, the FTC has held in this case that it is permissible, on a record devoid of any evidence to support a difference in treatment between SCM and Kraftco, to predicate a more severe order against one of two respondents who committed the same violation on the fact that that respondent chose to exercise its constitutional rights to due process by defending against the Staff's charges—thereby requiring the Commission to expend extra time and money to prove its case.

In *North Carolina v. Pearce*, 395 U.S. 711 (1969), the Supreme Court categorically rejected the argument that one's exercise of his constitutional right to due process, by litigating charges made against him, could be used as a reason for treating him more harshly than one who did not exercise his rights. While *Pearce* was decided in a criminal rather than a regulatory context, there is no good reason why administrative agencies should be given greater leeway than courts in penalizing respondents for exercising constitutional rights. The Court wrote:

"It can hardly be doubted that it would be a flagrant violation of the Fourteenth Amendment for a state trial court to follow an announced practice of imposing a heavier sentence upon every reconvicted defendant for the explicit purpose of punishing the defendant for his having succeeded in getting his

original conviction set aside. . . . "The imposition of such a punishment, 'penalizing those who choose to exercise' constitutional rights, 'would be patently unconstitutional.' *United States v. Jackson*, 390 U.S. 570, 581. And the very threat inherent in the existence of such a punitive policy would . . . serve to 'chill the exercise of basic constitutional rights.' [citations omitted]".

* * * *

"Due process of law, then, requires that vindictiveness against a defendant for having successfully attacked his first conviction must play no part in the sentence he receives after a new trial. And since the fear of such vindictiveness may unconstitutionally deter a defendant's exercise of the right to appeal or collaterally attack his first conviction, due process also requires that a defendant be freed of apprehension of such a retaliatory motivation on the part of the sentencing judge."

"In order to assure the absence of such a motivation, we have concluded that whenever a judge imposes a more severe sentence upon a defendant after a new trial, the reasons for his doing so must affirmatively appear. Those reasons must be based upon objective information concerning identifiable conduct on the part of the defendant occurring after the time of the original sentencing proceeding. And the factual data upon which the increased sentence is based must be made part of the record, so that the constitutional legitimacy of the increased sentence may be fully reviewed on appeal." 95 U.S. at 723-26."

Accord, Chaffin v. Stynchcombe, 412 U.S. 17, 18 (1973). And, in *Blackledge v. Perry*, 417 U.S. 21, 27-28 (1974), the Supreme Court extended the rationale of *Pearce* to cases in which a prosecutor³³ penalized an individual for exercising his constitutional rights. The Court wrote:

33. It is noteworthy that administrative agencies, like the FTC here, often take the roles of both prosecutor and adjudicator.

"A prosecutor clearly has a considerable stake in discouraging convicted misdemeanants from appealing and thus obtaining a trial *de novo* in the Superior Court, since such an appeal will clearly require *increased expenditures of prosecutorial resources* before the defendant's conviction becomes final, and may even result in a formerly convicted defendant's going free. And, if the prosecutor has the means readily at hand to discourage such appeals—by "upping the ante" through a felony indictment whenever a convicted misdemeanant pursues his statutory appellate remedy—the State can insure that only the most hardy defendants will brave the hazards of a *de novo* trial."

"There is, of course, no evidence that the prosecutor in this case acted in bad faith or maliciously in seeking a felony indictment against Perry. The rationale of our judgment in the *Pearce* case, however, was not grounded upon the proposition that actual retaliatory motivation must inevitably exist. Rather, we emphasized that 'since the fear of such vindictiveness may unconstitutionally deter a defendant's exercise of the right to appeal or collaterally attack his first conviction, due process also requires that a defendant be freed of apprehension of such a retaliatory motivation on the part of the sentencing judge.' 395 U.S. at 725. We think it clear that the same considerations apply here." (Emphasis added).

The constitutional considerations of *Pearce* have been extended beyond the criminal law area and have been specifically applied in the administrative context. In *Dan J. Sheehan Co. v. Occupational Safety and Health Review Commission*, 520 F.2d 1036, 1040 (5th Cir. 1975), *cert. denied*, 424 U.S. 965 (1976), the Court wrote:

"The question then becomes whether the threat of increased penalties after employer-initiated review violates the employer's due process rights under the

Fifth Amendment. Since this precise question has not been decided by this court, we take our guidance from developments in the criminal law area." (Citing *Pearce*, *Chaffin*, *Blackledge* and related cases.)

The Court upheld the statutory scheme involved in the *Sheehan* case only because that scheme contemplated judicial review in the Court of Appeals. The Court noted:

"If the Commission does not offer any reason for its decision to increase or if there is evidence that the increase was designed to penalize the employer for exercising its right to contest, the court will be in a position to correct such an abuse of discretion." (520 F.2d at 1041-42.)³⁴

Here, it is clear from the very language of the Commission's opinion that the only reason why a more severe cease and desist order was imposed on SCM was because SCM exercised its constitutional right to demand a hearing. (Opinion of the Commission, p. 15, A163).³⁵ It is unfair and wrong to punish SCM, as the Commission is doing under the rubric of "public interest", for exercising its due process right to be heard in its own defense. Certainly due process cannot stop at the FTC's doorstep.

This Court in *Marco Sales Co. v. FTC*, 453 F.2d 1 (2d Cir. 1971), reversed the Commission's issuance of a cease and desist order that unfairly discriminated against one of several corporations engaging in the same practice. This Court wrote:

34. Other cases in which the constitutional principles of *Pearce* were asserted or recognized in other than a criminal context include: *Atlas Roofing Co. v. Occupational Safety and Health Review Commission*, 518 F.2d 990, 1012-13 (5th Cir. 1975), *cert. granted*, 424 U.S. 964 (1976) (administrative context); *Beall Construction Co. v. Occupational Safety and Health Review Commission*, 507 F.2d 1041, 1045-46 (8th Cir. 1974) (administrative context); *Clark v. Universal Builders, Inc.*, 501 F.2d 324, 341 (7th Cir.), *cert. denied*, 419 U.S. 1070 (1974) (civil context).

35. In fact, SCM saved the Commission time and expense by agreeing to a Stipulated Record.

"[I]t is not that the Commission has failed to act against others but that it has adopted a positive regulatory approach to them totally inconsistent with its approach toward petitioners."

* * * *

"The arbitrary character of the Commission's action here consists of its total failure to even advert to, much less explain, its reason for the rigid ad hoc adjudicatory stance it adopted toward the petitioner and the flexible tolerance its industry regulation displayed to those utilizing the same or similar devices."

* * * *

"That an administrative agency is obligated to provide petitioner with an explanation for the difference in their treatment, is well established." (citations omitted) (453 F.2d at 6-7.)

Here, the Commission's only reason why SCM should be treated more severely than Krafteo, that SCM chose to exercise its constitutional rights, is a constitutionally impermissible consideration. The record stands silent, therefore, as to why SCM should be punished as compared with Krafteo.³⁶

The Sixth Circuit voiced the same concerns expressed by this Court in *Marco Sales* in another recent FTC case. *Ford Motor Co. v. FTC*, [1976] Trade Cases (CCH) ¶60,938 (6th Cir. 1976), *vacated on other grounds*, [1976] Trade Cases (CCH) ¶61,218 (6th Cir. 1976). That case involved a claim by Ford that the Commission had unfairly discriminated against it by permitting General Motors to enter into a less onerous consent order. In remanding to the Commission, the Court wrote

"Basically, however, the Commission simply refused to comment on, talk about, or give evidence of any serious consideration to petitioners' claims of com-

36. Indeed, the Commission gave no reason why SCM's order should be broader than Bond's—especially when it is the individual director, as analyzed in Point II, who is the focus of Section 8.

petitive disadvantage arising after petitioners had filed their consent orders because of the assertedly more favorable treatment of Ford's prime competitor, General Motors."

* * * *

"[The Commission] should . . . maintain both an even-handed approach to fierce competitors in a single industry and the appearance of doing so." (at 69,116 & 117).

The Commission's discriminatory treatment of SCM hardly complies with the "even-handedness" that the law requires of administrative agencies. It is particularly anomalous for the Commission to argue that it was justified in treating SCM more severely than Bond and Krafco because of considerations of "public interest" when the Commission accepted the Bond and Krafco orders as *in the public interest*. In short, the Commission's issuance of a substantially harsher cease and desist order against SCM, without providing a rational explanation therefore, disregarded the admonitions of this Court and others as to the importance of the even-handed treatment of similarly situated respondents.

Conclusion

SCM, therefore, respectfully urges this Court to grant its petition for review, to vacate the Commission's cease and desist order and to dismiss the Commission's complaint against SCM.

Respectfully submitted,

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Dated: New York, New York
May 27, 1977



STATUTORY APPENDIX

Clayton Act, § 8, 15 U.S.C. § 19.

* * *

"No person at the same time shall be a director in any two or more corporations, any one of which has capital, surplus, and undivided profits aggregating more than \$1,000,000, engaged in whole or in part in commerce, other than banks, banking associations, trust companies, and common carriers subject to the Act to regulate commerce, approved February fourth, eighteen hundred and eighty-seven, if such corporations are or shall have been theretofore, by virtue of their business and location of operation, competitors, so that the elimination of competition by agreement between them would constitute a violation of any of the provisions of any of the anti-trust laws. The eligibility of a director under the foregoing provision shall be determined by the aggregate amount of the capital, surplus, and undivided profits, exclusive of dividends declared but not paid to stockholders, at the end of the fiscal year of said corporation next preceding the election of directors, and when a director has been elected in accordance with the provisions of this Act it shall be lawful for him to continue as such for one year thereafter."

* * *

Clayton Act, § 11, 15 U.S.C. § 21.

* * *

"(b) Whenever the Commission or Board vested with jurisdiction thereof shall have reason to believe that any person is violating or has violated any of the provisions of sections 13, 14, 18, and 19 of this title, it shall issue and serve upon such person and the Attorney General a complaint stating its charges

in that respect, and containing a notice of a hearing upon a day and at a place therein fixed at least thirty days after the service of said complaint. The person so complained of shall have the right to appear at the place and time so fixed and show cause why an order should not be entered by the Commission or Board requiring such person to cease and desist from the violation of the law so charged in said complaint. The Attorney General shall have the right to intervene and appear in said proceeding and any person may make application, and upon good cause shown may be allowed by the Commission or Board, to intervene and appear in said proceeding by counsel or in person. The testimony in any such proceeding shall be reduced to writing and filed in the office of the Commission or Board. If upon such hearing the Commission or Board, as the case may be, shall be of the opinion that any of the provisions of said sections have been or are being violated, it shall make a report in writing, in which it shall state its findings as to the facts, and shall issue and cause to be served on such person an order requiring such person to cease and desist from such violations, and divest itself of the stock, or other share capital, or assets, held or rid itself of the directors chosen contrary to the provisions of sections 18 and 19 of this title, if any there be, in the manner and within the time fixed by said order. Until the expiration of the time allowed for filing a petition for review, if no such petition has been duly filed within such time, or, if a petition for review has been filed within such time then until the record in the proceeding has been filed in a court of appeals of the United States, as hereinafter provided, the Commission or Board may at any time, upon such notice and in such manner as it shall deem proper, modify or set aside, in whole or in part, any report or any order made or issued by it under this section. After the expiration of the time allowed for filing a petition for review, if no

such petition has been duly filed within such time, the Commission or Board may at any time, after notice and opportunity for hearing, reopen and alter, modify, or set aside, in whole or in part, any report or order made or issued by it under this section, whenever in the opinion of the Commission or Board conditions of fact or of law have so changed as to require such action or if the public interest shall so require: *Provided, however,* That the said person may, within sixty days after service upon him or it of said report or order entered after such a reopening, obtain a review thereof in the appropriate court of appeals of the United States in the manner provided in subsection (e) of this section."

* * * *

Federal Trade Commission Act, § 5, 15 U.S.C. § 45 (as amended January 4, 1975)

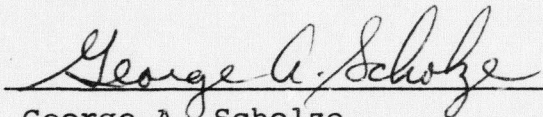
"(a) (1) Unfair methods of competition in or affecting commerce, and unfair or deceptive acts or practices in or affecting commerce, are declared unlawful."

* * * *

CERTIFICATE OF SERVICE

Service of two copies of the annexed brief was made upon the Respondent herein by placing same in the United States mail, postage prepaid, this 27th day of May, 1977 directed to:

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